

104TH CONGRESS  
1ST SESSION

# H. R. 512

To amend the Internal Revenue Code of 1986 to reduce the capital gains tax on stock of domestic corporations engaged in manufacturing and to index the basis of such stock for inflation.

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## IN THE HOUSE OF REPRESENTATIVES

JANUARY 13, 1995

Mr. MEEHAN (for himself, Mr. FRANKS of New Jersey, and Mr. QUINN) introduced the following bill; which was referred to the Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to reduce the capital gains tax on stock of domestic corporations engaged in manufacturing and to index the basis of such stock for inflation.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. REDUCTION IN INDIVIDUAL CAPITAL GAINS**

4 **RATE ON STOCK OF DOMESTIC MANUFAC-**  
5 **TURERS.**

6 (a) GENERAL RULE.—Subsection (h) of section 1 of  
7 the Internal Revenue Code of 1986 (relating to maximum  
8 capital gains rate) is amended to read as follows:

1 “(h) MAXIMUM CAPITAL GAINS RATE.—

2 “(1) IN GENERAL.—If a taxpayer has a net  
3 capital gain for any taxable year, then the tax im-  
4 posed by this section shall not exceed the sum of—

5 “(A) a tax computed at the rates and in  
6 the same manner as if this subsection had not  
7 been enacted on the taxable income reduced by  
8 the net capital gain,

9 “(B) 19 percent of the lesser of—

10 “(i) the 6-year qualified gain for the  
11 taxable year, or

12 “(ii) the portion of the taxpayer’s tax-  
13 able income for the taxable year which  
14 would be taxed at a rate in excess of 15  
15 percent (determined without regard to this  
16 subsection),

17 “(C) the 23.5 percent of the lesser of—

18 “(i) the 3-year qualified gain for the  
19 taxable year, or

20 “(ii) the excess of the amount de-  
21 scribed in subparagraph (B)(ii) for the tax-  
22 able year over the 6-year qualified gain for  
23 such taxable year, and

24 “(D) 28 percent of the excess (if any) of  
25 the net capital gain for the taxable year over

1 the sum of the amounts taken into account  
2 under subparagraphs (B) and (C).

3 “(2) 3-YEAR QUALIFIED GAIN.—For purposes  
4 of this subsection, the term ‘3-year qualified gain’  
5 means the lesser of—

6 “(A) the net capital gain for the taxable  
7 year, or

8 “(B) the net capital gain for the taxable  
9 year determined by taking into account only  
10 gain or loss from the sale or exchange of quali-  
11 fied manufacturer’s stock with a post-1994  
12 holding period of at least 3 years but less than  
13 6 years.

14 “(3) 6-YEAR QUALIFIED GAIN.—For purposes  
15 of this subsection, the term ‘6-year qualified gain’  
16 means the lesser of—

17 “(A) the excess of the net capital gain for  
18 the taxable year over 3-year qualified gain, or

19 “(B) the net capital gain for the taxable  
20 year determined by taking into account only  
21 gain or loss from the sale or exchange of quali-  
22 fied manufacturer’s stock with a post-1994  
23 holding period of at least 6 years.

24 “(4) QUALIFIED MANUFACTURER’S STOCK.—  
25 For purposes of this subsection, the term ‘qualified

1 manufacturer's stock' means stock of any domestic  
2 C corporation if any trade or business of such cor-  
3 poration is described in any 2-digit Standard Indus-  
4 trial Classification Code relating to manufacturing.

5 “(5) POST-1994 HOLDING PERIOD.—For pur-  
6 poses of this subsection, the term ‘post-1994 holding  
7 period’ means the portion of the holding period after  
8 December 31, 1994.

9 “(6) TREATMENT OF PASS-THRU ENTITIES.—

10 “(A) IN GENERAL.—In applying this sub-  
11 section with respect to any pass-thru entity, the  
12 determination of the period for which any gain  
13 or loss is properly taken into account shall be  
14 made at the entity level.

15 “(B) PASS-THRU ENTITY.—For purposes  
16 of subparagraph (A), the term ‘pass-thru entity’  
17 means—

18 “(i) a regulated investment company,

19 “(ii) a real estate investment trust,

20 “(iii) an S corporation,

21 “(iv) a partnership,

22 “(v) an estate or trust, and

23 “(vi) a common trust fund.”

24 (b) TECHNICAL AMENDMENTS.—

1           (1)(A) Section 170(e)(1)(B) of such Code is  
2           amended by inserting “the applicable percentage of”  
3           before “the amount of gain”.

4           (B) Section 170(e)(1) of such Code is amended  
5           by adding at the end the following new sentence:  
6           “For purposes of subparagraph (B), the term ‘appli-  
7           cable percentage’ means the percentage determined  
8           by dividing the rate of tax imposed by section 1(h)  
9           by 28, or, in the case of a corporation, the rate of  
10          tax imposed by section 1201(a) by 35.”

11          (2)(A) The second sentence of section  
12          7518(g)(6)(A) of such Code is amended by striking  
13          “28 percent (34 percent in the case of a corpora-  
14          tion)” and inserting “the rate of tax determined  
15          under such section”.

16          (B) The second sentence of section  
17          607(h)(6)(A) of the Merchant Marine Act, 1936, is  
18          amended by striking “28 percent (34 percent in the  
19          case of a corporation)” and inserting “the rate of  
20          tax determined under such section”.

21   **SEC. 2. REDUCTION IN CORPORATE CAPITAL GAINS RATE**  
22                           **ON STOCK OF DOMESTIC MANUFACTURERS.**

23          (a) GENERAL RULE.—Section 1201 of the Internal  
24          Revenue Code of 1986 (relating to alternative tax for cor-  
25          porations) is amended by redesignating subsection (b) as

1 subsection (c) and by striking subsection (a) and inserting  
2 the following:

3 “(a) GENERAL RULE.—If for any taxable year a cor-  
4 poration has a net capital gain, then, in lieu of the tax  
5 imposed by section 11, 511, or 831(a) (whichever applies),  
6 there is hereby imposed a tax (if such tax is less than  
7 the tax imposed by such section) which shall consist of  
8 the sum of—

9 “(1) a tax computed on the taxable income re-  
10 duced by the net capital gain, at the same rates and  
11 in the same manner as if this subsection had not  
12 been enacted,

13 “(2) 19 percent of the lesser of—

14 “(A) the 6-year qualified gain for the tax-  
15 able year, or

16 “(B) the portion of the taxpayer’s taxable  
17 income for the taxable year which would be  
18 taxed at a rate in excess of 15 percent (deter-  
19 mined without regard to this subsection),

20 “(3) 23.5 percent of the lesser of—

21 “(A) the 3-year qualified gain for the tax-  
22 able year, or

23 “(B) the excess of the amount described in  
24 paragraph (2)(B) for the taxable year over the  
25 6-year qualified gain for such taxable year, and

1 “(4) 35 percent of the excess (if any) of the net  
 2 capital gain for the taxable year over the sum of the  
 3 amounts taken into account under paragraph (2)  
 4 and (3).

5 “(b) DEFINITIONS AND SPECIAL RULE.—For pur-  
 6 poses of subsection (a)—

7 “(1) 3-YEAR QUALIFIED GAIN AND 6-YEAR  
 8 QUALIFIED GAIN.—The terms ‘3-year qualified gain’  
 9 and ‘6-year qualified gain’ have the respective mean-  
 10 ings given to such terms by section 1(h).

11 “(2) TREATMENT OF PASS-THRU ENTITIES.—  
 12 Section 1(h)(6) shall apply for purposes of this sec-  
 13 tion.”

14 (b) TECHNICAL AMENDMENT.—Clause (iii) of section  
 15 852(b)(3)(D) of such Code is amended by striking “65  
 16 percent” and inserting “the applicable percentage ” and  
 17 by adding at the end the following new sentence: “For  
 18 purposes of the preceding sentence, the term ‘applicable  
 19 percentage’ means 100 percent minus the percentage ap-  
 20 plicable under section 1201(a)).”.

21 **SEC. 3. INDEXING OF QUALIFIED MANUFACTURER’S STOCK**  
 22 **FOR PURPOSES OF DETERMINING GAIN OR**  
 23 **LOSS.**

24 (a) IN GENERAL.—Part II of subchapter O of chap-  
 25 ter 1 of the Internal Revenue Code of 1986 (relating to

1 basis rules of general application) is amended by inserting  
 2 after section 1021 the following new section:

3 **“SEC. 1022. INDEXING OF QUALIFIED MANUFACTURER’S**  
 4 **STOCK FOR PURPOSES OF DETERMINING**  
 5 **GAIN OR LOSS.**

6 “(a) GENERAL RULE.—Except as otherwise provided  
 7 in this subsection, if any qualified manufacturer’s stock  
 8 which has been held for more than 3 years (taking into  
 9 account only the portion of the holding period after De-  
 10 cember 31, 1994) is sold or otherwise disposed of, for pur-  
 11 poses of this title the indexed basis of the stock shall be  
 12 substituted for its adjusted basis.

13 “(b) QUALIFIED MANUFACTURER’S STOCK.—For  
 14 purposes of this section, the term ‘qualified manufactur-  
 15 er’s stock’ means stock of any domestic C corporation if—

16 “(1) any trade or business of such corporation  
 17 is described in any 2-digit Standard Industrial Clas-  
 18 sification Code relating to manufacturing, and

19 “(2) such stock is a capital asset in the hands  
 20 of the taxpayer.

21 “(c) INDEXED BASIS.—For purposes of this sec-  
 22 tion—

23 “(1) GENERAL RULE.—The indexed basis for  
 24 any stock is—



1           “(A) the adjusted basis of the stock, multi-  
2           plied by

3           “(B) the applicable inflation ratio.

4           “(2) APPLICABLE INFLATION RATIO.—The ap-  
5           plicable inflation ratio for any stock is the percent-  
6           age arrived at by dividing—

7           “(A) the gross domestic product deflator  
8           for the calendar quarter in which the disposi-  
9           tion takes place, by

10          “(B) the gross domestic product deflator  
11          for the calendar quarter in which the stock was  
12          acquired by the taxpayer (or, if later, the cal-  
13          endar quarter ending on December 31, 1994).

14          The applicable inflation ratio shall never be less than  
15          1. The applicable inflation ratio for any stock shall  
16          be rounded to the nearest  $\frac{1}{1000}$ .

17          “(3) GROSS DOMESTIC PRODUCT DEFLATOR.—  
18          The gross domestic product deflator for any cal-  
19          endar quarter is the implicit price deflator for the  
20          gross domestic product for such quarter (as shown  
21          in the first revision thereof).

22          “(d) TREATMENT OF REGULATED INVESTMENT  
23          COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

24          “(1) ADJUSTMENTS AT ENTITY LEVEL.—

1           “(A) IN GENERAL.—Except as otherwise  
2           provided in this paragraph, the adjustment  
3           under subsection (a) shall be allowed to any  
4           qualified investment entity (including for pur-  
5           poses of determining the earnings and profits of  
6           such entity).

7           “(B) EXCEPTION FOR QUALIFICATION  
8           PURPOSES.—This section shall not apply for  
9           purposes of sections 851(b) and 856(c).

10          “(2) ADJUSTMENTS TO INTERESTS HELD IN  
11          ENTITY.—

12               “(A) IN GENERAL.—Stock in a qualified  
13               investment entity shall be qualified manufactur-  
14               er’s stock for any calendar month in the same  
15               ratio as the fair market value of the qualified  
16               manufacturer’s stock held by such entity at the  
17               close of such month bears to the fair market  
18               value of all assets of such entity at the close of  
19               such month.

20               “(B) RATIO OF 90 PERCENT OR MORE.—If  
21               the ratio for any calendar month determined  
22               under subparagraph (A) would (but for this  
23               subparagraph) be 90 percent or more, such  
24               ratio for such month shall be 100 percent.

1           “(C) RATIO OF 10 PERCENT OR LESS.—If  
2           the ratio for any calendar month determined  
3           under subparagraph (A) would (but for this  
4           subparagraph) be 10 percent or less, such ratio  
5           for such month shall be zero.

6           “(D) VALUATION OF ASSETS IN CASE OF  
7           REAL ESTATE INVESTMENT TRUSTS.—Nothing  
8           in this paragraph shall require a real estate in-  
9           vestment trust to value its assets more fre-  
10          quently than once each 36 months (except  
11          where such trust ceases to exist). The ratio  
12          under subparagraph (A) for any calendar  
13          month for which there is no valuation shall be  
14          the trustee’s good faith judgment as to such  
15          valuation.

16          “(3) QUALIFIED INVESTMENT ENTITY.—For  
17          purposes of this subsection, the term ‘qualified in-  
18          vestment entity’ means—

19                 “(A) a regulated investment company  
20                 (within the meaning of section 851), and

21                 “(B) a real estate investment trust (within  
22                 the meaning of section 856).

23          “(e) OTHER PASS-THRU ENTITIES.—

24                 “(1) PARTNERSHIPS.—In the case of a partner-  
25          ship, the adjustment made under subsection (a) at

1 the partnership level shall be passed through to the  
2 partners.

3 “(2) S CORPORATIONS.—In the case of an S  
4 corporation, the adjustment made under subsection  
5 (a) at the corporate level shall be passed through to  
6 the shareholders.

7 “(3) COMMON TRUST FUNDS.—In the case of a  
8 common trust fund, the adjustment made under sub-  
9 section (a) at the trust level shall be passed through  
10 to the participants.

11 “(f) DISPOSITIONS BETWEEN RELATED PERSONS.—

12 “(1) IN GENERAL.—This section shall not apply  
13 to any sale or other disposition of property between  
14 related persons except to the extent that the basis  
15 of such property in the hands of the transferee is a  
16 substituted basis.

17 “(2) RELATED PERSONS DEFINED.—For pur-  
18 poses of this section, the term ‘related persons’  
19 means—

20 “(A) persons bearing a relationship set  
21 forth in section 267(b), and

22 “(B) persons treated as single employer  
23 under subsection (b) or (c) of section 414.

24 “(g) TRANSFERS TO INCREASE INDEXING ADJUST-  
25 MENT.—If any person transfers cash, debt, or any other

1 property to another person and the principal purpose of  
2 such transfer is to secure or increase an adjustment under  
3 subsection (a), the Secretary may disallow part or all of  
4 such adjustment or increase.

5 “(h) SPECIAL RULES.—For purposes of this section:

6 “(1) TREATMENT AS SEPARATE STOCK.—A  
7 substantial contribution to capital of a corporation  
8 shall be treated as separate stock in such corpora-  
9 tion.

10 “(2) STOCK WHICH IS NOT QUALIFIED MANU-  
11 FACTURER’S STOCK THROUGHOUT HOLDING PE-  
12 RIOD.—The applicable inflation ratio shall be appro-  
13 priately reduced for periods during which stock is  
14 not qualified manufacturer’s stock.

15 “(3) TREATMENT OF CERTAIN DISTRIBUTI-  
16 TIONS.—A distribution with respect to stock in a  
17 corporation which is not a dividend shall be treated  
18 as a disposition.

19 “(4) ACQUISITION DATE WHERE THERE HAS  
20 BEEN PRIOR APPLICATION OF SUBSECTION (a)(1)  
21 WITH RESPECT TO THE TAXPAYER.—If there has  
22 been a prior application of subsection (a) to stock  
23 while such stock was held by the taxpayer, the date  
24 of acquisition of such stock by the taxpayer shall be

1 treated as not earlier than the date of the most re-  
 2 cent such prior application.

3 “(i) REGULATIONS.—The Secretary shall prescribe  
 4 such regulations as may be necessary or appropriate to  
 5 carry out the purposes of this section.”

6 (b) CLERICAL AMENDMENT.—The table of sections  
 7 for part II of subchapter O of chapter 1 of such Code  
 8 is amended by inserting after the item relating to section  
 9 1021 the following new item:

“Sec. 1022. Indexing of qualified manufacturer’s stock for pur-  
 poses of determining gain or loss.”

10 (c) ADJUSTMENT TO APPLY FOR PURPOSES OF DE-  
 11 TERMINING EARNINGS AND PROFITS.—Subsection (f) of  
 12 section 312 of such Code (relating to effect on earnings  
 13 and profits of gain or loss and of receipt of tax-free dis-  
 14 tributions) is amended by adding at the end thereof the  
 15 following new paragraph:

16 “(3) EFFECT ON EARNINGS AND PROFITS OF  
 17 INDEXED BASIS.—

**For substitution of indexed basis for adjusted  
 basis in the case of the disposition of qualified man-  
 ufacturer’s stock, see section 1022(a).”**

18 **SEC. 4. EFFECTIVE DATE.**

19 The amendments made by this Act shall apply to tax-  
 20 able years beginning after December 31, 1994.

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